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ABSTRACT

In many countries there have been major changes in the financial operations of the university. Change has occurred in the context of diminishing public resources, and this has translated, in most cases, into financial constraint within the university. This situation has led to pressure from the government, and from within the university itself in some cases, for a diversification in the sources of financial support for the university. It is clear that the university can no longer relay solely on government funding if it is to remain financially healthy. New styles and mechanisms of financial management are necessary. Based on the experiences of some selected Organisation for Economic Cooperation and Development (OECD) and Latin American countries, this booklet attempts to identify the context and the main functions of financial management and suggests a set of strategies for financial management at the national and institutional levels. (Contains 2 tables, 1 figure, and 13 references.) (SLD)

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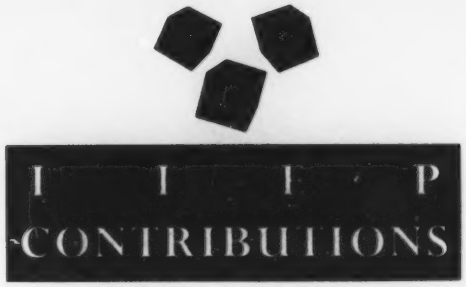

No. 27

New strategies for financial management in universities: the experience of OECD member countries and Latin American countries

Bikas C. Sanyal
Michaela Martin

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Contents

Introduction		1
Part I.	Financial management functions	2
Part II.	The context of university financial management	5
Part III.	Changes in institutional financial management in Western industrialized countries	11
Part IV.	Recent Latin American experiences	19
Part V.	Strategies for financial management	26
Selected references		34

New strategies for financial management in universities: the experience of OECD member countries and Latin American countries

by Bikas C. Sanyal
Michaela Martin

Introduction

In many countries of the world there have been major changes in the financial operation of the university. Change has occurred within the context of diminishing public resources, and this has translated, in most instances, into financial constraint within the university.

This situation has led to pressure from government, and from within the university itself in some cases, for a diversification in the sources of financial support for the university. It is clear that the university can no longer rely solely on government funding if it is to remain financially healthy. New procedures and new criteria for the allocation of resources and the evaluation of the uses made of increasingly scarce resources are essential.

Part I

Financial management functions

Introduction

The main functions of financial management in the university are the following:

- to protect university finances against improper use;
- to manage the university's cash reserves prudently;
- to produce financial indicators that assist planning and the effective general management of the university;
- to ensure that resources are allocated and used efficiently in accordance with the objectives of the university;
- to establish resource allocation mechanisms that encourage individuals and departments to generate income for the university.

1. Protection of university finances

Of all the functions, this is the basic control function; it is the most traditional and by far the most widespread role of university financial managers. All the other activities are, at least to some extent, dependent on this task being satisfactorily performed. As management information systems and auditing procedures improve, financial irregularities will be detected more easily and the regulations can be made less onerous.

2. Management of cash reserves

The extent of the second function, management of the university's cash reserves, depends largely on the overall legal framework within which the university operates.

In countries where universities have no financial autonomy and no cash reserves, obviously the function does not exist. However, as more and more countries move in the direction of decentralization and devolved budgets, this function becomes a very important one.

In countries with a well-developed banking system, properly managed cash reserves can generate a significant income for the university. The management of the institution's income-generating enterprises is growing in importance. Bookshops, guest-houses, printing services, conference bookings, sports facilities, consultancy services, intellectual property rights and many other services all generate income, costs and cash balances that need to be properly managed in the interests of the university.

3. Production of financial indicators

The third function, generation of useful performance indicators, is of growing importance. Modern management systems depend upon comprehensive information, and a large proportion of the information needed concerns the direct or indirect use of financial resources.

Any new financial management system must take on the routine production of financial effectiveness and efficiency indicators.

4. Allocation of resources

The fourth function, ensuring that resources are allocated and used efficiently in accordance with the objectives of the university, is one of the key activities in a self-managed institution.

It is the function that has grown most in importance during the past 10 years in many countries. There has been a shift from line-by-line input-oriented budgets, in which universities have very little discretion over how they use their resources, to output or performance-oriented programme budgets, in which universities can use their funds more or less as they wish in order to produce the agreed output.

This shift has resulted in a great need for financial managers who can devise budgets and accountability procedures to ensure that institutional

objectives and output targets are met, that agreed budgets are not exceeded and that all individuals and groups are encouraged to act in ways that are consistent with the interests of the university as a whole.

5. Encouraging income generation

The previous function overlaps that of encouraging individuals and units in the university to generate income on behalf of the university as a whole and to reward them for doing so.

There are two ways in which individuals can be rewarded for undertaking activities that produce extra income:

- one is to treat such activities as part of the normal work programme of the university and to enable consultancy work to count as a criterion in applications for promotion;
- the other is to allow individuals to retain a part of the income that is generated, either for themselves individually, or for the department or centre in which the individual has a specific interest.

Part II

The context of university financial management

Introduction

The financial management of a higher education institution operates within constraints determined by four main factors:

- the mission;
- the organizational structures;
- the sources and mechanisms of finance.

1. Mission

Recently the term 'Mission' is being utilized very frequently to refer to the goals, objectives, the general functions and priorities of an organization. The 'Mission Statement' is a manifestation, usually brief, synthesizing the functions and priorities of an organization.

For a large and complex system of higher education the mission statement has the particular function of informing the potential clients (students and the sponsors of consultancy and research services) and the funding agencies of the government to examine the special role and place of an institution within the national system of higher education.

There is often a reciprocal relationship between mission and funding:

- a university's mission may influence the public funds it receives;
- however, the funds it obtains, and the way they are allocated, help determine its mission.

It is self-evident that the financial management of a university ought to operate within its mission. A university with a mission that emphasizes community service will not allocate resources in the same way that a major research institution will, for example.

However, in practice, and possibly because they may be seen as a constraint on future flexibility, mission statements tend usually to be couched in very general terms and are often interchangeable between institutions.

2. Organizational structures

A university as an organization consists of a complex network of interdependent academic staff, support staff, offices, departments, research centres and committees. The appropriate allocation of financial resources ensures the smooth interaction of the various components.

Depending on the organizational structure, the central function of financial management covers a number of activities:

- routinely following elaborate procedures to protect public funds against misuse;
- establishing incentive systems to encourage income generation;
- rewarding those who use resources efficiently.

In recent years, in many countries there has been a perceptible shift away from almost exclusive concern with bureaucratic financial administration towards more entrepreneurial financial management in which finance is actively used to motivate individuals, and subsidiary groups within the university, to act in ways that are consistent with its overall output objectives.

Financial management has become increasingly concerned with what economists have come to call the 'principal-agent' problem. In other words, how does the person who controls resources persuade those using them to act in ways that are consistent with the objectives of the principal. The larger and more complex an organization, the more difficult it is to do this.

In broad terms the decisions on how resources are to be allocated can be made in universities by different management procedures:

- collegial;
- bureaucratic; or
- entrepreneurial.

The role of financial management is different in the three cases:

- in collegial management systems academic criteria tend to be paramount, and university administrators are seen to be performing a supporting role – in extreme cases the university may be seen to be run for the benefit of its academic staff;
- in bureaucratic management structures the roles are reversed, decision-making is hierarchical, the administration is dominant and academic staff are 'managed' by professional managers and administrators;
- in entrepreneurial organizations, individuals and departments best able to generate income are the dominant partners and the most important function of financial managers is to ensure that there are adequate incentives to encourage them to do so – customers decide.

Reduced to the simplest terms the organization structure of a university consists of four areas:

- a central administration;
- centrally provided services;
- specialized teaching and research departments;
- non-academic services.

Even this simple model of the organizational structure of a university allows for seven basic financial management procedures as listed below:

(1) All resources are received by the centre, and are allocated, managed and administered from the centre (the pure bureaucratic model).
(2) Strategic decisions are taken at the centre but routine decisions and implementation are made by departments (decentralized bureaucracy).

(3) Income is top sliced for central administration and services: the remainder is allocated to departments to use in accordance with academic priorities (collegial model).
(4) Most income is passed on to departments which 'buy' services from the centre (hybrid model).
(5) Income is 'earned' by departments but administered from the centre (corporate entrepreneurialism).
(6) Income is earned by departments: it is 'taxed' to cover central administrative costs and the remainder is spent by departments according to the requirements of the external 'purchasing' agency (managed entrepreneurialism).
(7) Income is earned by departments and retained by them: they 'buy' central services as they are needed (*laissez-faire* model).

In practice, of course, resource allocation procedures are usually a mix of more than one model. For example, externally funded research often requires somewhat different financial management procedures from the centrally funded core activities of the university.

The models are best seen as points on a spectrum:

- at one extreme all resources – staff, space, and consumables – are allocated centrally;
- while at the other extreme, faculties or departments are almost autonomous cost centres meeting their own requirements from income that they themselves have generated.

Some universities are very near to the top end of this spectrum and others are at the bottom. Many developing countries still have very bureaucratic systems of financial management imposed on them by governments, but everywhere there is some shift towards devolution downwards of financial management responsibilities.

3. Sources and mechanisms of finance

During the past 10 years, many countries have experienced a shift from input-based to output-based public funding of institutions.

In input-based funding systems, public funds are provided to meet the costs of the inputs into the institution, for example, staff salaries, equipment, consumable items, buildings. Institutional managers are required to spend the funds on the inputs for which they are provided, but within these constraints it is the university which decides what outputs to produce.

Output-based funding pays the institution for the services it provides. In effect the government 'buys' services from the organization. It is for the institution to decide how to allocate resources between the various inputs in order to produce the contracted outputs.

It is important to appreciate that these shifts from input-based to output-based funding are occurring not only in higher education; most public services are experiencing similar developments. The shifts reflect ideological and technological changes that go far beyond higher education.

The implications for financial managers of a shift from input specification to output specification are very large indeed. It represents a shift in the power relationships between the university and the external funding body, and also within the institution between the managerial and the academic staff.

Broadly, there are five ways in which government can fund universities.

(1) The university submits a periodic (usually annual) budget based on its estimate of the costs of its commitments to staff salaries and other essential inputs. It may bargain with the government over the percentage of this budget which is to be met. The grants are 'earmarked' or 'hypothecated', which means that the university must spend the funds on the items specified by the government.
(2) The university receives a single block grant based on the grant received in the previous period plus an increment, and is free to spend this money as it wishes within very broad legal limits.
(3) Funds are based on a formula reflecting past performance, but the university is able to spend the funds as it wishes once they are received. The basis of most formulae is student numbers (weighted by subject, level of study etc.) but, increasingly, governments are trying to include in the formula a weighting to reflect the academic performance of the students.
(4) The government buys academic services from the university. This

is similar to (3) above but funds are based on prospective future performance rather than performance in the past.

(5) The university sells its teaching, research and consultancy services to a wide variety of different customers, students' employers and public authorities.

Again, the actual mechanisms are often a combination of two or more of these models. In particular, various combinations of (3) (4) and (5) are often discussed. For example, formulae may determine much of the funding while a proportion is determined by the 'sale' of incremental student places to the government. One much discussed possibility is student vouchers, whereby students pay fees but are reimbursed in whole or in part by government grants.

However, it is usually possible to identify a dominant model corresponding to one of these ideal types.

Another important point is that most funding models are, in practice, incremental in that universities receive last year's allocation plus or minus an increment, with differing consequences:

- when the increment is positive, there are few problems;
- when it is negative, there are usually considerable difficulties in allocating the cuts and firm financial management is needed if the effects are not to be randomly distributed (for example, staff reduction based upon individual departures rather than policy decisions) to the long-term detriment of the university.

It is not possible to relate these external funding mechanisms exactly to the internal resource allocation procedures, but experience in many countries suggests that item (1) above and, to some extent, item (3), require a substantial measure of bureaucratic regulation to ensure that resources are spent as required by the government or central funding agency. Item (2) and some aspects of item (3) usually permit some degree of collegial management in which academic priorities are very influential. Items (4) and (5) require in varying degrees market-orientated management in which entrepreneurialism and the satisfaction of market demands are rewarded.

Part III

Changes in institutional financial management in Western industrialized countries

Introduction

All institutions must undertake at least the short-term annual budgeting process (that is, the acquisition or mobilization of resources, their allocation, the monitoring and control of their utilization, the production of accounts and reports) and undergo an audit.

However, issues involved in financial management may in reality be very different according to a number of factors:

- the type and extent of government funding;
- steering policies and regulations;
- the type of institution (private/public, research/teaching);
- the decision-making structure (centralized/decentralized).

It was to be expected that rather radical changes would be necessary in the internal structures for financial management in those universities which have had to become more entrepreneurial in nature.

The administration of a university in which the main financial decisions are concerned with allocating a predetermined sum according to academic priorities is very different from one in which most of the important decisions are taken outside the institution. Neither of these has much in common with the market-oriented university in which income is earned directly by the activities of the basic operating units and the individual members of staff within them. In the latter case, one of the main preoccupations of the managers is to establish a system of incentives that will encourage all members of the operating units to respond to changing market opportunities

in a manner that simultaneously contributes to the income of the university and maintains its academic integrity.

Consulting and the provision of services are becoming increasingly important as sources of funding. They are viewed as a significant new funding mechanism in Western industrialized countries. In the western part of Germany, external earnings of institutions have increased by 50 per cent over the last 15 years, the industrial component having risen rapidly by 130 per cent between 1980 and 1985. In the USA, the public and private institutions receive about the same proportion of their incomes from the sale of services (20 and 24 per cent respectively).

Other regions are beginning to follow suit: some technological institutions seem to have benefited greatly even in the developing countries. In China, the Guandong Light Industrial Research Institute has increased its research income nine-fold.

1. Institutional financial management in systems under self-regulation and accountability

The necessity for sound financial control necessitated many of the changes in university management:

- the strengthening of central management;
- the re-grouping of basic units to act as cost centres;
- the upgrading of a member of the finance staff to Deputy Vice-Chancellor for Financial Affairs or the inclusion of a Financial Manager in the top decision-making group;
- the articulation of mission statements, so as to measure performance against objectives and orient allocations to priority areas.

The United Kingdom, the Netherlands and Finland among others, provide interesting examples of change within a self-regulated system. Probably the most radical changes have taken place in the United Kingdom.

Example One: The United Kingdom

Since the early 1980s government policy has been dominated by a number of factors, including the following:

- the concern to reduce public expenditure per higher education student;
- the need to increase efficiency by encouraging universities to earn income and also to be much more strictly accountable for grants received, a requirement which has become much more important in the 1990s.

The first round of cuts in the early 1980s ranged from 6 to 30 per cent, according to the institution. Some special arrangements mitigated the worst effects, such as, early retirement compensation and the protection of priority engineering and technical programmes. Subsequently, strategies focused on separating resources for teaching and research, and making funding conditional on delivery.

The 1988 Education Reform Act gave greater autonomy for resource management of institutions, but set stricter accountability measures. It was expected that resources would likely be used more effectively if those responsible for educational services were given maximum discretion to deploy them in response to local needs.

The Universities Funding Council (UFC) implemented a system of funding whereby institutions put in bids for certain numbers of student places by broad bands of disciplines. In practice, universities were reluctant to bid too low and thereby force down the unit of funding even more. As a result, in 1991 the UFC abandoned the system and set only provisional targets. As of 1992, it was decided that for the next two years universities would be guaranteed only the number of funded student places allocated for 1991-1992. Any decisions on increases were to be based on the proportion of students at a university above the funded number.

In short, the government had found a way of securing expansion at low marginal cost and higher education institutions were obliged to accede in order to obtain their funds. Public spending per graduate in the United Kingdom is now lower than in most other European countries, the exception being countries with open admission systems like France, where there are high drop-out rates.

The UFC has published a code of practice for university internal and external audit, and supervises the financial health of institutions.

This restructuring of the mechanisms for funding the universities imposed great strains on the management of institutions with a number of results:

- many of them devolved budgets to the departmental level, either including or excluding staff salaries;
- most institutions also appointed or increased the number of senior officers concerned with fund raising, industrial liaison and overseas students;
- more information was made available within the institution for accountability and decision-making purposes;
- the quantity and quality of comparative information was improved, particularly with the annual publication, *University management statistics and performance indicators*, which obliges institutions to ask questions and seek reasons for variance, thereby making it possible to compare expenditure on central administration, libraries, computers and premises;
- programme budgeting has been generally adopted and the cost per student per annum by discipline is now compared amongst universities.

Figure 1 demonstrates the type of change and streamlining that took place in financial management decision-making structures in one university in the United Kingdom. The change to centralized line management from collegial management will be noted, as well as the grouping of faculties.

Most universities have adopted some type of formula funding in allocating resources internally by using weightings (for example, 1 Ph.D = 3 undergraduates for the purpose of staff, library and laboratory allocations), as well as norms and ratios. Some maintain central control over the establishment of staff positions. Others allocate all funds, after taking off the resources necessary for central administration, to faculties to be shared by consensus among the departments.

Thus there is a new emphasis on the department as a performer and the pressure of competition between departments. Management of finance is considered to be one of the critical tasks for the next decade. The role of finance officers in the United Kingdom universities is becoming increasingly important.

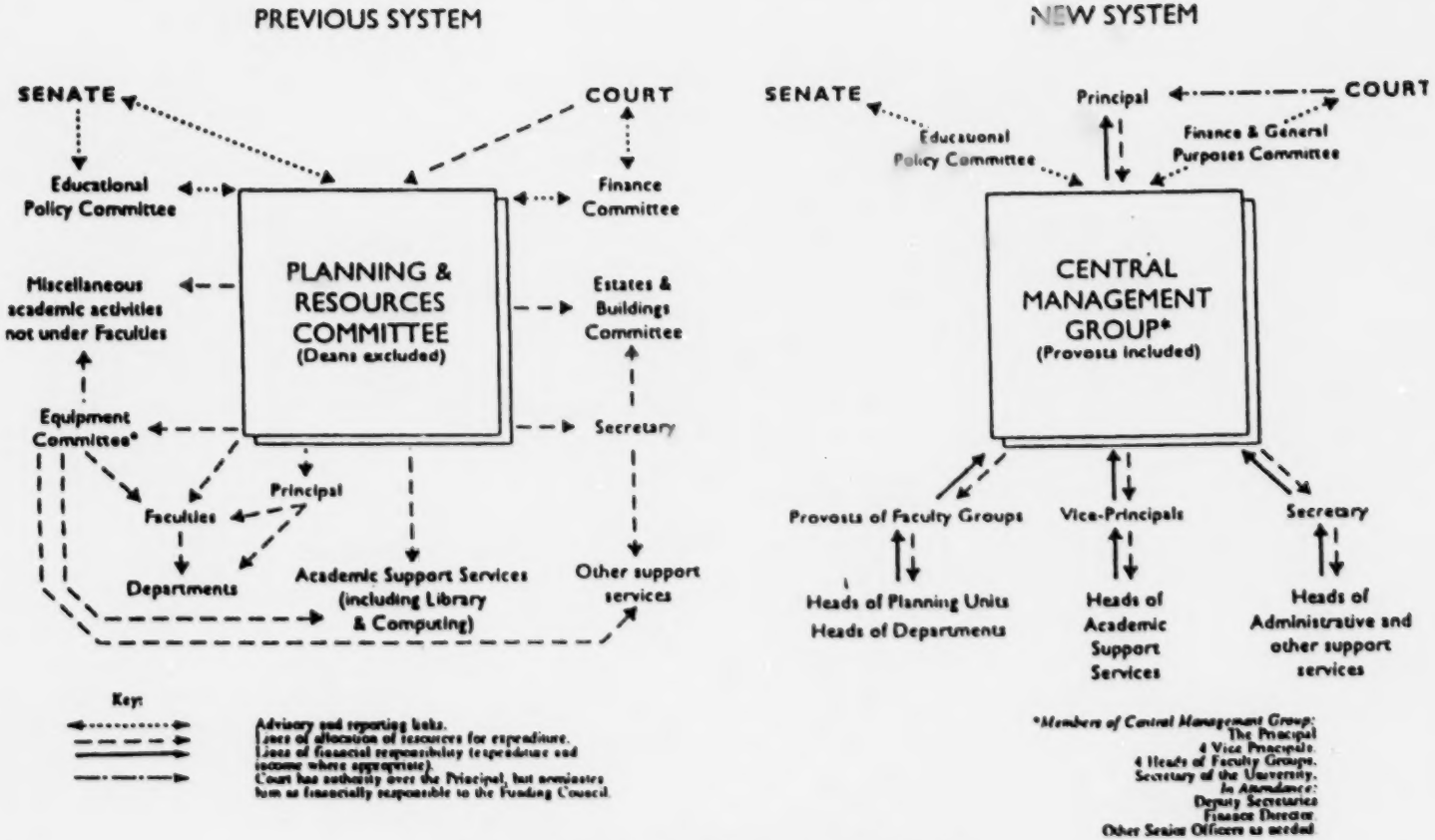

Figure 1. Lines of financial responsibility at *University X*

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There has been a rise in the need for professional administrators with the skills necessary for effective management within a rapidly changing higher education system, with new funding structures and new penalties.

In 1995 the government contribution has decreased further. The funding these days is based on a set of parameters: percentage of academic staff, number of students, number of graduates, percentage of students on continuing education, quality of training and research. These measures have reduced expenditure by 15 per cent and are expected to reduce it further.

Example Two: The Netherlands

The Netherlands adopted a different method of funding: institutions receive a lump sum to cover staff and maintenance based on the number of first-year students minus drop-outs, which they are free to spend according to their own preferences. However, salaries are limited by legislation and government approval is required for the highest posts. Investment is covered by project funds, and research funds are allocated on Full Time Equivalent (FTE) academic staff and according to past levels. Ex-post evaluation has been introduced to aid quality control. As in the United Kingdom, student numbers increased and the unit cost per student decreased.

This funding system has meant the following:

- institutions must adapt their capacity to changing demands and the job market;
- they must assess their output in terms of quality with the aid of Ministry inspectors;
- programmes of study are to be more flexible, i.e. modular;
- each student will have vouchers for a given number of modules at different times in his or her career;
- each institutions will also be given a mission budget to finance innovative projects and centres of excellence.

The reaction of the universities to the new funding system seemed to depend on how insecure they felt. The University of Amsterdam experimented with Zero-based Budgeting, which requires the justification of every proposed expenditure, beginning theoretically from a base of zero.

On the other hand, the small and new University of Twente decided it would have to make some very radical changes if it were to survive. It divided its annual government funding into 85 per cent for distribution to the faculties and 15 per cent for incentives and new strategic areas. Faculties were pressured to seek income and rationalize their programmes by making them cost centres, to which all costs were charged (even overheads), and budgets (in line with the national funding system) were output based. A new accounting system was introduced and a separate business organization established. The system has been working for several years now and is acknowledged to be the most advanced in the Netherlands. The University no longer has financial problems, self-generation of income is increasing rapidly and so are student numbers. However, this entrepreneurial style of financial management brings other problems: faculty staff have to be given a great deal of training and explanation. Also, in order to be able to establish output-related costs, there must be an efficient management information system which can give precise results.

Example Three: Finland

The Nordic countries demonstrated a long-term vision in respect of funding their institutions of higher education. Even before the situation became critical they had adopted measures of economy.

Finland, in particular, embarked on a policy of experimentation in improving financial management, designating two institutions (the University of Joensuu and the Helsinki School of Economics) as pilot projects for change. After 20 years of government control, with all staff civil servants and the budgets set by line item, these two institutions were given lump-sum allocations and the task of devising an efficient financial management system which, after approval, would be used by all institutions in 1994.

Joensuu, as a small institute, felt it needed to be in the vanguard as regards efficiency. It decentralized financial management to departments, organized departmental self-evaluation, a management information system and a means of dialogue both between academic heads and with the government in order to negotiate the outcomes to be achieved.

The process has been gradual. In 1991 lump sums were allocated to departments with no set obligations except for salaries. As of 1992,

departments could decide how to use their staff; until then teaching responsibilities were defined by category.

Benefits were seen in rising cost consciousness, and the possibility of trade-offs influenced decisions:

- not all vacant posts were filled;
- there was more use of part-time staff;
- there were more instances of sharing staff with other departments.

It was hoped that by 1994, when the Finnish Government announced that it intended to make economies by imposing a 5 per cent staff cut, that the system as a whole would be able to benefit from the experience of the pilot institutions to make a smooth transition to lump-sum budgeting and departmental management.

Part IV

Recent Latin American experiences

Several authors have identified the problems of higher education in Latin American countries. These are: massive social demand, deterioration in quality, difficulty of students to follow full time courses due to lack of financial resources, low salaries for academic staff obliging them either to look for second or third job or quitting academic profession, the power of teacher and student unions causing any change to be highly politicized, to cite only a few. The governments have set limits to their expenditures and have met the pressure of social demand by allowing the growth of private institutions, of which there are now large numbers, usually offering the cheaper types of education.

The basic structure of the Latin American public universities has not changed much since their establishment. They maintain an independent faculty system with tenured professors. They have a shortage of qualified administrative staff, suffer from lack of incentives and information system. Some institutions (e.g. provincial universities in Colombia, Peru and Ecuador) operate with a very small number of students in some faculties. There is evidence of an excessive number of administrative and academic staff in public universities (in Brazil, for example, the student/teacher ratio is on average, 8:1 whereas in private universities it is two to three times higher). One can also observe underutilization of physical space in some countries due to the academic calendar.

As indicated above the administration has been highly politicized due to the interference of the unions on the one hand and the state on the other. In certain institutions, the social and political framework has not so far favoured management change. For state institutions, government bureaucracy is a major problem. Universities are not free to establish budgets or intervene in salary scales, so that universities deal only with minor current expenses.

However, very recently, certain governments have begun to put forward proposals to abandon incremental budgeting, to lessen isolation and institute evaluation as an instrument of policy. Traditionally most higher education systems in Latin America have been equipped with an accreditation type of evaluation by which newly founded institutions or newly created programmes receive official approval after meeting minimum quality standards. It is conducted either by a ministerial body, by an autonomous body at the university or a buffer type organization. However, new types are being set up which aim at comparability or improvement. These are not without their problems; in Venezuela university evaluation is being contested.

Selecting the countries which have tried to implement changes in institutional management one can observe that in Brazil student participation has not changed; in Mexico it has reduced whereas in Chile (where privatization has been emphasized) and Venezuela (where financial allocation has remained at the same level) student participation has increased.

Number of students per 100,000 inhabitants

	1985	1989	1990	1991	1992
Brazil	n.a.	1065	1074	1075	1079
Chile	1629	1843	1938	2144	2145
Colombia	1328	1496			1554
Mexico	1598	1589	1552		1477
Venezuela	2581	2798	2847		2853

Source: UNESCO.

As regards expenditure, less information is available. The effects of privatization can be seen in Chile and Colombia with the introduction of student fees and student loans.

Current expenditure per student at tertiary level
as a multiple of GNP per capita

	1989	1990	1992
Brazil	0.59	1.10	1.09
Chile	1.11	0.29	0.24
Colombia	0.41	0.36	0.38

Despite problems at the national level, in this region, there are individual institutions, which have taken management initiatives. In addition, funds have been made available for computers and information systems in large universities (UNAM, Mexico, Sao Paulo, Rio de Janeiro and some other universities in Brazil.) which means that the tools are available to assist efforts to achieve more efficient management.

Mexico

The Mexican Government has attempted to steer its university system towards more regulated expansion, institutional evaluation, closer links with the productive sector and differential salary scales for academics. However, with few exceptions, public universities follow a rigid traditional organization, attempts to enrol students in new technology fields have failed and the interests of pressure groups have so far proved stronger than state rhetoric. The results of very recent initiatives are not yet available, i.e. the 1989 National System to stimulate academic work which grants incentive bonuses to 30 per cent of staff in each institution, and the 1989 National Commission for Evaluation of Higher Education. The 1990 and 1991 institutional evaluations found that few universities could give complete information and most were descriptive and not analytical. The government now proposes a National System of Evaluation as from 1993 which could cover institutions, sub-systems and programmes by peer review.

In Mexico, the state is responsible for more than 90 per cent of the operational expenses of the universities. Now the government is attempting to increase the financing of other sectors of the society. The UNAM has accepted after a long discussion to introduce an annual tuition fee of US$670 per student. They are being encouraged to offer consultancy services to the private sector so that the link between the universities and the productive sector can be closer.

The Secretariat of Public Education (SEP, the main co-ordinator of state universities) has denounced institutional non-co-operation, while the National Association of Universities has requested more time and information for discussions. The SEP allocations are lump sums for teaching and research based on annual university budget requests divided into broad categories. Funding per student has fallen and universities have increased tuition fees and price of services to the students and public. However, it is generally recognized that financial procedures are inadequate: there is a lack of cost analysis, reporting and managerial supervision. Many institutions are in a state of chronic deficit.

Chile

Chile's Committee to reform the law on higher education in 1991 proposed to reinforce autonomy and self-regulation by setting up a buffer National Council of Higher Education to accredit new universities and supervise the existing ones. The Dutch model was suggested for evaluation. Student loans or grants would be given and a Fund for Institutional Development would provide incentives to improve quality. The legislation to enforce these proposals was not approved as of 1993. Resistance is strong: the private universities do not want obligatory evaluation, public universities do not want to share funds with the private sector and linking performance to the budget frightens them. University staff are accustomed to leaving the government to manage.

Since 1981 Chile has been reducing the state's responsibility for funding higher education allowing the growth of private institutions and technical training centres as well as implementing a system of student loans.

Today, four types of funding exist: (i) a lump sum calculated on a historical basis, (ii) a proportion given according to number of students in the first year, (iii) credits for students who meet some criteria, and (iv) a small percentage linked to the best 20,000 academic results. Civil service status for staff has been abolished and salary differentials permitted. From 1981 to 1991, according to one source state funding to universities fell from 4 per cent of GNP to 2.5 per cent.

Approximately 16 per cent of university income is obtained from services (staff have to give much time for this activity now), with 10 per cent derived from investment. According to another source, while efficiency has

increased apparently with more students consuming less public resources, input-output ratios in the old universities have deteriorated and unit costs per graduate are still high.

Brazil

In Brazil, self-governance was given to the universities under the 1988 Constitution, but it is subject to a series of administrative and financial restrictions. Universities still cannot manage their budget and redistribute it internally, but must respect the criteria set for budget items, and adhere to national salary scales. The current cost, at present, represents 90 per cent of the budget of the federal universities. The budget is prepared with a Congressional decree after discussions with the Ministries of Finance and Education. There was the intention to introduce a lump-sum system of budgeting based on a formula incorporating efficiency and quality, so that the universities could be autonomous in allocating and utilizing resources. But the different interest groups have opposed. Collegial and political models of decision-making predominate within institutions and decisions are usually based on compromises between competing groups. There is strong resistance to the cancellation of courses with low attendance and to curricular change. On the other hand, there has been an excessive increase in the number of commissions and electoral colleges. Teaching staff are preoccupied with negotiations about pay; real income has fallen and many staff take additional part-time jobs or leave to take better paying positions in newly established private universities. The scope for improvements in financial management is obviously very limited. However, the State of Sao Paulo has granted 9 per cent of tax revenue to state universities, with the right to make their own internal allocations, while the government has announced its intention to phase in a new formula and performance indicator-based budget system over the next 10 years. The problem is that the universities are opposed to this move.

Argentina

Having the phenomenon of hyper-inflation under control, the Government of Argentina has instituted an annual budget from 1992. The government intended to change from line item budgeting to lump-sum grants and to deregulate salaries but the universities disagreed. Public universities also resist introduction of fees. However, the government asked the Congress for authorization of allocation of 80 per cent of funds for specific

uses allowing the remaining 20 per cent at the disposal of the universities. The government has forbidden any reduction in its allocation to the universities which earn extra resources. This has created an incentive for the universities to seek additional sources of funding through research and consultancy.

However, the programmes met with resistance. The government attempts to improve efficiency have been seen with suspicion because of the fear that this might lead to the reduction of public financing of higher education in the future. In spite of this, the universities are looking for new sources of funding in recent years. The public universities have been opposed to the introduction of fees to recover costs. This subject is controversial because it would imply amendment of the Constitution.

Colombia

A study in Colombia has compared financial management in public and private institutions. Here the state institutions are 90 per cent financed by the government, despite rises in tuition fees and sale of services. The average cost per student in private institutions is less than half that in public but this is explained to some extent by lower spending on equipment and the fact that, in private institutions, the majority of staff are part-time and there is only one support staff for every 12 students compared to one per seven in public. But the private institutions maintain a tighter control over employee productivity, and financial management is facilitated by the fact that they receive tuition fees at the beginning of the semester, while state universities receive their grants irregularly and have to pay employment benefits and subsidize cafeterias, residences and extension courses. In addition, some prestigious private universities earn high levels of income from short courses and receive donations, while this is not the case of the state universities.

Cuba

In Cuba, a process of decentralization has started giving substantial autonomy in management and flexibility in design of curriculum and use of academic staff. The country has been merging uneconomic institutions and faculties to achieve efficiency and promoting external activities to increase financial resources.

The University of Havana has been offering consultancy services. The university earned 26 per cent of its income from the Ministry of Higher Education in 1994. A percentage of the income of the university goes to the Ministry to finance important centres of higher education. The university has a formula to distribute the additional income received by an academic staff from external sources. Twenty-five per cent goes to the academic staff; out of the remaining 75 per cent half (i.e. 37.5 per cent) goes to the Ministry of Higher Education; the remaining is divided into equal shares between the central administration of the university and the faculty (18.5 per cent each). The income of all the universities increased from a mere US$500,000 in 1990 to US$5.5 million in 1994.

Part V

Strategies for financial management

Introduction

The discussion of national and institutional experiences in this Module has demonstrated the impact of the national administrative system on the type of strategies adopted by higher education institutions in the area of financial management.

It has been shown that, on the one hand, many of those governments in self-regulated systems, which traditionally interfered little in the affairs of their higher education institutions, are now more and more concerned with particular institutional outcomes and performance. On the other hand, many governments in centrally planned systems have started to devolve administrative autonomy to the institutions of higher education. In both cases, institutions are expected to be accountable and to set up mechanisms of evaluation which demonstrate that funds are used effectively and efficiently. One may therefore conclude that the trend in both self-regulated and formerly centrally planned and controlled systems is towards governmental steering at a distance.

1. National strategies

Within this context, governments have applied different strategies to create a framework to facilitate creative financial management at the institutional level.

Strategy One: Mechanisms for resource allocation

With regard to resource allocation mechanisms, the following strategies have been discussed:

- line item budgets are replaced by lump-sum budgets with a view to making those who are close to the primary activities of higher education responsible for decisions;
- increasingly, resources are allocated on the basis of funding formulae which include built-in output parameters (e.g. number of graduates) in order to give clear signs to the higher education institutions of expected outputs and outcomes, and to create an incentive for performance;
- a suggested set of performance indicators is developed by government to indicate the criteria against which institutions will be evaluated, and to establish a monitoring instrument for the higher education system;
- incentive budgeting and special-purpose funds are made available whereby government money is redeployed to achieve certain impacts or to stimulate innovative projects in government priority areas.

All these governmental strategies try to combine the need for national co-ordination and the setting of guidelines with the aim of stimulating initiative and innovative behaviour within institutions of higher learning.

Strategy Two: Allow for flexibility in the utilization of resources

Nowadays higher education institutions worldwide tend to find themselves in relatively unstable environments. They have to be able to react quickly to upcoming opportunities and threats. As a consequence, the rules pertaining to the utilization of public resources need to be flexible and to allow for creativity. Especially in systems using line items for input steering, governments have to create a legislative framework that will allow for flexibility in the disbursement of funds and budgeting, in carrying over funds at the end of the year, and in moving money from one budget line to another.

Strategy Three: Create a framework conducive to diversification of resources

The legislative framework also needs to be conducive to the generation of supplementary income and the diversification of resources. More and more governments allow institutions, their departments or individuals to retain a part of the financial revenue that they have generated. Some even supplement income from their higher education institutions from the provision of their services to new clientele. The autonomy to use the money thus gained on institutional projects, or to invest it in the market, constitutes an incentive for resource diversification.

Strategy Four: Make new resources available through student loans

The introduction of student loans as a means of cost recovery for higher education is a measure which is increasingly being implemented to generate new resources at the systems level. Student loans are expected to make students more responsible for their programme of study. They are also expected to contribute to equity considerations since students of higher education benefit from a relatively high private rate of return on public investment in education. However, a student loan system requires that there be an administrative framework to ensure that the loans are repaid with a reasonable default rate.

Strategy Five: Develop a private sector of higher education

More and more countries are encouraging the establishment or the development of private sector institutions of higher education in order to reduce the financial burden on the state. This is expected to alleviate the pressure from secondary school leavers for an inadequate number of places in the public sector institutions. This allows for expansion of the higher education without lowering the quality of the education provided in the public sector.

Strategy Six: Allow for financial planning at the institutional level

In the previous sections, it has been made clear that institutions need to plan with at least a medium-term perspective. Strategic planning has been discussed as one of the approaches to systematize institutional development. In order to co-ordinate institutional and national planning, it is important to

have a framework for joint negotiation and multi-year contracts which formalize the results of this negotiation.

Institutions need to have funds released on a regular basis, in order to allow financial managers to execute their routine functions properly.

2. Institutional strategies

Strategy One: Integrate financial management and institutional policies

The previous Module pointed out the importance of conceiving financial plans and budgets as a management tool for the co-ordination, control and evaluation of a university in the present context of financial crisis. It is also important that financial management aims and procedures be subordinate to overall institutional policies. Financial management should be a means for the implementation of strategic goals and objectives. Therefore, there needs to be close integration and joint planning of academic and administrative affairs. Programme-linked budgeting can be an instrument for the translation of institutional policy into the budget. Zero-basing which allows for the consideration of alternative patterns of expenditure may create the flexibility for cutbacks and growth during the budgetary year.

Strategy Two: Facilitate the generation of income and cost recovery at the basic unit level

If there has been a major shift in the functions of financial management, it is with respect to the new and increasingly important tasks of income generation and cost recovery. These tasks can be achieved through a variety of means:

- the commercialization and marketing of university programmes and activities (e.g. continuing education programmes);
- creating university owned enterprises, commercializing patents and innovations;
- renting out of university facilities and space;
- increasing student fees for tuition, examination or for board and accommodation;

- attracting employer sponsorship of students or trainees;
- attracting overseas students at differential fee or on full-cost basis;
- managing the cash reserve in such a way that it generates as much interest as possible;
- investing in the stock market;
- attracting endowment of institutions, staff or halls of residence by industry, commerce or philanthropists;
- bringing in gifts and endowments from alumni;
- attracting research grants from national or international resources.

If a university intends to promote the generation of income and cost recovery, it is necessary to encourage the basic units and staff to do so, and to be willing to return an appropriate amount to the university. Consultancy work should be encouraged, and individuals or basic units should be allowed to retain a part of the income generated. Such work should be counted in applications for promotion or senior posts.

A strategy geared towards income generation might also imply the need to create or strengthen those structures in the university concerned with, for instance, marketing university services, such as the department of communication or extension services.

Strategy Three: Reduce costs and increase efficiency

Given the financial crisis within many public sector budgets, institutions of higher education are expected to increase the efficiency of resource utilization. They are expected to achieve the same level of effectiveness with fewer resources. This necessarily implies a reduction in their costs which should not be done at the expense of the quality of services provided.

The major expenditure in higher education is on staff costs. These costs are relatively inflexible since salary scales are normally decided by a public authority outside the higher education institution, or in negotiation with the trade unions at the institutional level. For this reason, institutions usually try to cut back non-academic costs such as capital investment, administrative costs and building and maintenance. However, it should be noted that some of these budgets, at least in the longer term, are essential for the quality of the academic services provided. Some strategies are worth considering:

- evaluating the cost of services provided by the university and considering if sub-contracting (e.g. for cleaning and maintenance) is more cost-effective;
- setting up mechanisms for cost analysis and trying to link costs and benefits, separating costs related to teaching and research;
- developing costing norms and other standards, also with a view to fully costing service activities offered by the institution to outside clientele.

Strategy Four: Develop appropriate administrative structures

The above-mentioned strategies relating to the new functions of financial management imply that the supporting structures and mechanisms of financial management change.

So far, the following strategies adopted by higher education institutions have been identified:

- devolving financial responsibility and accountability to those units who are in charge of major decisions at the academic level;
- developing the concept of an internal resource allocation authority, e.g. a resource planning committee to mobilize, allocate and monitor the utilization of resources;
- regrouping basic units to act as cost centres and restructuring the university's activities and financial accounting records around cost/profit centres;
- making cost centres sensitive to cost implications by charging all programme costs to them (e.g. cost of renting and maintaining space and equipment);
- upgrading the role of the financial manager within the university hierarchy;
- strengthening of the internal audit department;
- centralizing the purchasing function in one department in order to exert better control on all purchases.

A sensitive question for most institutions relates to the desired degree of financial autonomy to be given to the basic units. It is advisable for the central administrative level to retain a part of the budget for innovative and exploratory initiatives, in order to retain a margin for the implementation of initiatives of common interest to all constituting parts of a higher education

institution. Thus, seed money may be made available for projects deemed important to the institution as a whole.

Strategy Five: Develop an appropriate management information system (MIS)

Many of the strategies mentioned above imply the availability of timely and accurate data, be they related to a new type of relationship of the institution with its national authority or related to the need for institutional monitoring of policies. With the complexity of administrative procedures, a management information system becomes a necessary tool to produce such timely information on a regular basis. However, an MIS must be adapted to the degree of devolution of administrative authority prevailing in the institution. It should inform everybody with authority to commit funds, about the main indicators relating to the financial health of the institution. Therefore, it should generate financial effectiveness and efficiency indicators and assist the production of the annual report by providing university management statistics and performance indicators.

An MIS should also fulfil the following purposes:

- make available transparent information at all institutional levels on all incoming resources;
- contribute to the development of a clear picture of all costs and benefits derived from programme activities (evaluation);
- provide information on who suffers and how bills are paid if government funds are insufficient.

Strategy Six: Provide adequate training

The changes in structures and procedures in the area of financial management which have been outlined above can only take place if the persons in charge are willing and able to implement, on a daily basis, the necessary changes. Institutions committed to devolving administrative responsibility to basic units, will have to combine change in procedures and techniques as well as the introduction of such new or different tools as an MIS, together with an integrated programme of training for academic decision-makers.

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In many countries there have been major changes in the financial operation of the university. Change has occurred within the context of diminishing public resources, and this has translated, in most instances, into financial constraint within the university. This situation has led to pressure from government, and from within the university itself in some cases, for a diversification in the sources of financial support for the university. It is clear that the university can no longer rely solely on government funding if it is to remain financially healthy.

New styles and mechanisms of financial management are necessary. Based on the experiences of some selected OECD and Latin American countries this booklet attempts to identify the context and the main functions of financial management and suggests a set of strategies for financial management at the national and institutional level.

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